

# NEWLY CREATED CONSEQUENCES CAUSED BY THE CHANGE OF INCOME TAX

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## **Abstract**

*Amendments of the Law on Income Tax and increase of the personal deduction will result in the decrease of liabilities and payments of employment income tax.*

*Since income tax is a joint income of state and local governments, cities and municipalities will get a smaller portion of the funds to finance their needs, also many programs and activities of cities and municipalities will come into question.*

*In order to achieve plans and forecasted activities, cities and municipalities introduced an increase of surtax. With this increase of surtax local self-government units tried to compensate for the decreased income and cash inflow from employment income tax. This paper strives to explore the thesis that local self-government units, through the increase or introduction of additional surtax, attempt to collect the same amount of financing funds as in previous periods.*

**Keywords:** *income tax, personal deduction, surtax, cities and municipalities*

**JEL Classification:** F65, G2, H2

## 1. INTRODUCTION

Provisions of the Constitution of Republic of Croatia (NN 05/14) regulate that everyone is obliged to participate in the settlement of the public expenses, in accordance with their own economic opportunities. In addition, it indicates that the tax system is based on principles of equity and equality.

Equity in taxation (Jelcic, 2001, 109) can be achieved by establishing the obligation of payment of taxes to all citizens of the country, or it can be based on equality in taxation, so that taxation is conducted according to the economic capacity of taxpayers.

Main feature of the income tax is its social function, which undoubtedly arises from the regulations on the income tax and numerous provisions designed to reduce the tax liability for natural persons.

Income tax payer is always a natural person. When determining the amount of income taxes, many personal facts have to be taken into account, which is why this tax can be considered personal.

When determining the tax liability, taxpayer is entitled to use tax deductions or non-taxable income. Amount will depend on many factors and circumstances - whether taxpayer is employed or in pension, whether he lives alone or supports a family, if he has health problems, where does he reside etc.

## 2. TYPES OF INCOME AND PERSONAL DEDUCTION

According to the provisions of Law of income tax (NN 143/14), taxable income based on the income source, is:

- employment income,
- self-employment income,
- income from property and property rights,
- capital income,
- insurance income,
- other sources of income.

The income tax base is total amount of income from employment. In case of employment income, basis for income calculation is reduced in amount of personal deduction for each month of tax period. Reason for reduction of the

employment income and reduction of tax base is the fact that taxpayers' income necessary for provisions for basic existential needs should not be taxed. Main deductions under the existing law can be increased for:

- part of personal deduction for dependent children,
- part of personal deduction for dependent spouse,
- part of personal deduction for other dependent members of the family,
- part of personal deduction for invalidity.

According to the Law on income tax, personal deduction has been changed many times since 1994, when it was first introduced.

**Table 1:** Overview of the changes of the primary personal deductions from 1994 to 2015

Period	Primary personal deduction
1.1.-31.12.1994.	332,00
1.2.-30.6.1994.	400,00
1.7.-31.12.1994.	500,00
1.1.1995.-31.12.1996.	700,00
1.1.1997.-31.12.1998.	800,00
1.1.1999.-31.3.2000.	1.000,00
1.4.2000.-31.12.2002.	1.250,00
1.1.2003.-31.12.2004.	1.500,00
1.1.2005.-30.6.2008.	1.600,00
1.7.2008.-29.2.2012.	1.800,00
1.3.2012.-31.12.2014.	2.200,00
1.1.2015.-	2.600,00

Source: Bartolec, S., Uljanić, I. (2015.) „Osobni odbitak–značenje, povijesni pregled i izmjene“, Porezni vjesnik, 55

The personal deduction is used only in the disbursement of employment income, while in other types of income personal deduction is not used.

## 2.3. SALARY CALCULATION – EMPLOYMENT INCOME

Law concerning the financing of units of local and regional self-government (Official Gazette of RC (NN 147/14)) determines the sources of funding and

financing of the municipality or city. Cities and municipalities can implement following taxes:

1. Surtax on income tax
2. Consumption tax
3. Tax on holiday houses
4. Tax on trade name
5. Tax on use of public land

For income taxpayers, municipality or city can determine the amount of surtax on income tax in following way:

- A municipality at the rate of up to 10%
- A city with a population below 30,000 at a rate of up to 12%
- A city with a population over 30,000 at a rate of up to 15%
- The city of Zagreb at a rate of up to 30%

The basis for the calculation of surtax is determined according to the amount of income tax. By amendments of the Law on Income Tax, personal deduction from 1 January 2015 has been increased and is up to 2,600.00 kn per month. Until 31 December 2014, the basic personal deduction was up to 2,200.00 kn per month.

Income tax rates applicable in 2014 and 2015 were 12%, 25% and 40%.

Following table shows the base for calculation of income:

**Table 2:** Changes of tax groups from 1.1.2015.

	According to the Law on Income Tax until 31.12.2014.	Changes of the Law from 1.1.2015.
Tax rate	Monthly tax base	Monthly tax base
12%	Up to 2.200,00 kn	Up to 2.200,00 kn
25%	Above 2.200,00 kn up to 8.800,00 kn	Above 2.200,00 up to 13.200,00 kn
40%	Above 8.800,00 kn	Above 13.200,00 kn

Source: Bartolec, S., Uljanić, I. (2015.) „Osobni odbitak–značenje, povijesni pregled i izmjene“, Porezni vjesnik, 59

Changes of the basic personal deductions and changes of the tax rate on self-employment income resulted in higher net amounts when calculating income, also influencing the amount of the income tax. Since majority of the local self-government units collect funding mostly with income tax, this change might lead to income reduction in general. In order for local self-government

units to easily and evenly collect income from tax, a large number of local self-government units used the legal possibility and introduced surtax. From 1 January 2015, 26 local self-government units have introduced surtax and thereby increased their income. Most of local self-government units introduced a maximum of 10% surtax. The example below shows how this reflected the income from taxes and surtaxes and net earnings from employment income and other types of income.

Example below elaborated employment income with the personal deduction without dependent members, with the gross income of 3017.61 kn in 2014 and 3029.55 kn in 2015 (minimum wage) and incomes of 5,000.00 kn, 10,000.00 kn 15,000.00 kn in 2014 when there was no surtax and in 2015 when surtax of 10% was introduced.

It is evident that in 2015 local self-government units will profit more in case of 10.000 kn gross salary than in the year before.

**Table 3:** Comparison of income without dependent members (lower wages)

	“ minimum” gross		5.000 kn gross	
	Until 31.12.2014.	from 1.1.2015. + surtax	Until 31.12.2014.	from 1.1.2015. + surtax
GROSS	3.017,61	3.029,55	5.000,00	5.000,00
Retirement insurance 20%	603,52	605,91	1.000,00	1.000,00
Income	2.414,09	2.423,64	4.000,00	4.000,00
Personal deduction	2.200,00	2.423,64	2.200,00	2.600,00
Basis	214,09	0,00	1.800,00	1.400,00
Tax 12%	25,69	0,00	216,00	168,00
Tax total	25,69	0,00	216,00	168,00
Surtax 10%	0,00	0,00	0,00	16,80
Tax + surtax	25,69	0,00	216,00	184,80
NET	2.388,40	2.423,64	3.784,00	3.815,20

Source: Calculation from author

**Table 4:** Comparison of income without dependent members (higher wages)

	10.000 kn gross		15.000 kn gross	
	Until 31.12.2014.	from 1.1.2015. + surtax	Until 31.12.2014.	from 1.1.2015. + surtax
GROSS	10.000,00	10.000,00	15.000,00	15.000,00
Retirement insurance 20%	2.000,00	2.000,00	3.000,00	3.000,00
Income	8.000,00	8.000,00	12.000,00	12.000,00
Personal deduction	2.200,00	2.600,00	2.200,00	2.600,00
Basis	5.800,00	5.400,00	9.800,00	9.400,00
Tax 12%	264,00	264,00	264,00	264,00
Tax 25%	900,00	800,00	1.650,00	1.800,00
Tax 40%	0,00	0,00	400,00	0,00
Tax total	1.164,00	1.064,00	2.314,00	2.064,00
Surtax 10%	0,00	106,40	0,00	206,40
Tax + surtax	1.164,00	1.170,40	2.314,00	2.270,40
NET	6.836,00	6.829,60	9.686,00	9.729,60

Source: Calculation from author

If the taxpayer has two children as dependent members, with gross income of 3017.61 kn in 2014 and 3029.55 kn in 2015 (minimum wage) and gross income from 5000.00 kn, 10,000, 00 kn and 15,000.00 kn, income of local self-government units is reduced in cases where there is a tax liability, as shown in Table 5 and 6.

**Table 5:** Comparison of income with two children (lower wages)

	"minimum" gross		5.000 kn gross	
	Until 31.12.2014.	from 1.1.2015. +surtax	until 31.12.2014.	from 1.1.2015. +surtax
GROSS	3.017,61	3.029,55	5.000,00	5.000,00
Retirement insurance 20%	603,52	605,91	1.000,00	1.000,00
Income	2.414,09	2.423,64	4.000,00	4.000,00
Personal deduction	4.840,00	5.720,00	4.840,00	5.720,00
Basis	0,00	0,00	0,00	0,00
Tax total	0,00	0,00	0,00	0,00
Surtax 10%	0,00	0,00	0,00	0,00
Tax + surtax	0,00	0,00	0,00	0,00
NET	2.414,09	2.423,64	4.000,00	4.000,00

Source: Calculation from author

**Table 6:** Comparison of income with two children (higher wages)

	10.000 kn gross		15.000 kn gross	
	Until 31.12.2014.	from 1.1.2015. +surtax	until 31.12.2014.	from 1.1.2015. +surtax
GROSS	10.000,00	10.000,00	15.000,00	15.000,00
Retirement insurance 20%	2.000,00	2.000,00	3.000,00	3.000,00
Income	8.000,00	8.000,00	12.000,00	12.000,00
Personal deduction	4.840,00	5.720,00	4.840,00	5.720,00
Basis	3.160,00	2.280,00	7.160,00	6.280,00
Tax 12%	264,00	264,00	264,00	264,00
Tax 25%	240,00	20,00	1.240,00	1.020,00
Tax 40%	0,00	0,00	0,00	0,00
Tax total	504,00	284,00	1.504,00	1.284,00
Surtax 10%	0,00	28,40	0,00	128,40
Tax + surtax	504,00	312,40	1.504,00	1.412,40
NET	7.496,00	7.687,60	10.496,00	10.587,60

Source: Calculation from author

#### 4. INCOME FROM INCOME TAX

In addition to employment income tax, income tax is calculated also for the self-employment income, income from property and property rights, capital income, insurance income and other sources of income. Income from property and property rights is paid at the rate of 12% without the personal deduction, with the prior deduction of the tax base by 30%. Advance on capital income is calculated at the rate of 40% without the personal deduction. Advance on capital income in share option purchase is taxed at a rate of 25%, and advance of tax on capital income from dividends and profit shares at the rate of 12% without the personal deduction. Advance on insurance income is calculated at the rate of 12% without the personal deduction. Advance on other sources of income is calculated at the rate of 25% without the personal deduction, and in the case of remuneration, the tax base is reduced for 25%. Tax Administration brings the decision on advance on income from self-employment in proportion to the income of the preceding calendar year. In all these cases, the personal deduction has no effect on the increase or decrease of income, regardless of the amount. Meaning that tax liability of income tax in 2014 and 2015 remains the same

regardless of the increased personal deduction. By introducing or increasing of the surtax, local self-government units realised increase of their income for the amount of the surtax.

Table 7 analyses income of 4 municipalities in 2014, with visible correlation of income tax and its influence on the personal deduction (JLS A, B, C, D).

**Table 7:** Incomes influenced by personal deductions

	JLS A	JLS B	JLS C	JLS D
Employment income	5.182,98	31.339,28	57.856,60	14.266,37
Employment income	1.119.809,32	2.144.231,56	1.001.487,92	1.198.214,16
Pensions from abroad	20.779,00	29.374,41	16.823,66	9.012,03
Annual tax return	-1.007.313,18	-946.227,36	-1.641.253,08	-1.039.839,45
TOTAL:	138.458,12	1.258.717,89	-565.084,90	181.653,11

*Source:* Tax Administration information system, calculation from author

**Table 8:** Incomes not influenced by personal deductions

	JLS A	JLS B	JLS C	JLS D
Self-employment income	75.355,34	269.707,88	101.848,38	286.715,63
Self-employment income	2.927,18	13.383,26	7.841,16	8.837,80
Rental income	17.431,84	129.880,19	181.392,27	42.757,24
Income of rent	-	533.245,29	43.444,69	450,00
Other income	4.321,62	9.119,14	15.825,03	422,60
Other income	78.397,76	95.539,86	231.063,48	102.121,89
Income from capital	241.056,00	25.409,40	435.099,60	1.413,28
Income from copyright works	-	-	6.422,71	381,82
TOTAL:	419.489,74	1.076.285,02	1.022.937,32	443.100,26

*Source:* Tax Administration information system, calculation from author

Table 7 and 8 are showing the income of 4 local self-government units from employment where only unit B achieved significant income from income tax, regardless of income during the calendar year.

In the other 3 local self-government units no significant income was realised. Main reason for that is that most of the tax was returned to the taxpayers through annual income tax return. Unit C even has a negative income from employment income tax.



In 2014 all units achieved significantly higher income when it comes to other sources of income than from employment income. (JLS A in relation to other sources of income and employment income - 419,489.74 kn and 138,458.12 kn; JLS D in relation to other sources of income and employment income - 443,100.26 kn and 181,653.11 kn). From this, it can be concluded that local self-government units will achieve much higher income from all other sources of income than from employment income, compared to 2014. In addition, it can be concluded that compared incomes are in majority, in year under review, at a similar level.

## 5. CONCLUSION

Income tax and real estate transfer tax, according the provisions of Law concerning the financing of units of local government and regional self-government, are joint taxes. In 2014, income tax was divided between state, municipality/city and county in following ratio:

- 56,5% - municipality/city,
- 16% - county,
- 12% - decentralized functions,
- 15,5% - share for adjustment for decentralized functions.

From 1.1.2015., ratio is changed and now is:

- 60% - municipality/city,
- 16,5% - county,
- 6% - decentralized functions,
- 16% - share for adjustment for decentralized functions.

Above-mentioned percentage of tax income (especially from employment income and other income taxes) as well as shares in the income structure of local self-government units, provide the following data:

**Table 9:** Expected income from local self-government units (JLS) in 2015

	JLS A	JLS B	JLS C	JLS D
Employment income in 2014	138.458,12	1.258.717,89	-565.084,90	181.653,11
Other income in 2014	419.489,74	1.076.285,02	1.022.937,32	443.100,26
TOTAL:	557.947,86	2.335.002,91	457.852,42	624.753,37
Total income of JLS in 2014	334.768,72	1.401.001,75	274.711,45	374.852,02
Expected increase in 2015	41.948,97	107.628,50	102.293,73	44.310,02
Total expected tax and surtax in 2015	376.717,69	1.508.630,25	377.005,18	419.162,05

Source: Tax Administration information system, calculation from author

In 2015 local self-government units will have 10% increased income with introduced surtax in comparison to decrease of income when calculating the increase of personal deductions in employment income.

Total income in 2015 for local self-government unit A should be increased for 60% of income from 2014 of new surtax.

## LITERATURE

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